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No. 84-1258

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

CHEMICAL BANK AND
WASHINGTON PUBLIC POWER SUPPLY SYSTEM,
Petitioners,

v.

PUBLIC UTILITY DISTRICT NO. 1 OF BENTON
COUNTY, WASHINGTON, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the Supreme Court of the State of Washington

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF FOR THE PUBLIC SECURITIES ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF THE PETITION

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

The Public Securities Association (PSA) hereby respectfully moves, pursuant to Rules 36.1 and 42 of the Rules of this Court, for leave to file the attached brief *amicus curiae* in support of the petition for a writ of certiorari. The consent of petitioners, Chemical Bank and Washington Public Power Supply System, has been obtained. Consent of each respondent has not been granted. A request for consent was made to the first named respondent, Public Utility District No. 1 of Ben-

ton County, Washington, and many of the other Washington Public Utility Districts. That request was refused.

The decision of the Supreme Court of the State of Washington raises serious constitutional questions under the fifth and fourteenth amendments and article 1, section 10 of the United States Constitution. If allowed to stand, the decision may have serious impact upon the ability of state and local governments to finance their capital projects through public debt offerings.

PSA, as the representative of broker-dealers and banks that underwrite over 90 percent of municipal bond issues, has a substantial and continuing interest in the outcome of this litigation as more fully explained in the attached brief. PSA is requesting the opportunity to make its views known to the Court and to underscore and supplement the argument presented by the Petitioners.

Accordingly, PSA hereby requests that the Court grant this Motion for Leave to File Brief *Amicus Curiae* and accept the attached brief as part of the record in this case

Respectfully submitted,

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February 28, 1985

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BRIEF OF THE PUBLIC SECURITIES ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF THE PETITION

INTEREST OF *AMICUS CURIAE*

The Public Securities Association (PSA) is a national trade organization of approximately 300 members, predominantly broker-dealers and banks. PSA's members underwrite in excess of 90% of the bonds and other obligations of state and local governments publicly sold in the United States. These obligations are commonly referred to as "municipal bonds." PSA members have underwritten municipal bonds in all 50 states and the District of Columbia. Among the purposes of PSA is the maintenance of a stable, efficient, and orderly municipal bond market. The principles at stake in this case are extremely important to these PSA purposes, and to public confidence in the municipal bond market. Accordingly, PSA and its members are vitally interested in this Court granting review.

STATEMENT OF THE CASE

The Municipal Bond Marketplace. Over 6,000 new issues of municipal bonds are marketed or placed each year in the United States. Public Securities Association, Statistical Yearbook of Municipal Finance, The New Issue Market in 1983 (1984). In 1984, the dollar amount of newly issued municipal bonds was more than $100 billion. Public Securities Association, Statistics Available in its Municipal Securities Computer Database (to be published in 1984 Statistical Yearbook of Municipal Finance). The principal amount of municipal bonds outstanding in the United States is approximately $500 billion. Board of Governors of the Federal Reserve System, Flow of Funds Accounts, Assets and Liabilities Outstanding, First Quarter 1984, No. Z.1 (March 1984). Individual investors, either directly or through unit-investment trusts and open-end bond funds, are an increasingly im-

portant segment of this market. For example, such individual investors purchased about 70% of the new issues of municipal bonds during the third quarter of 1984. Board of Governors of the Federal Reserve System, Flow of Funds Accounts, Third Quarter 1984, No. Z.1 (November 1984).

Municipal bonds are issued by state and local governments for a wide range of public purposes. Proceeds from such bonds are used to construct and maintain such public projects as roads, water and sewer lines, and schools. Such financing is critical now and access by issuers to the municipal capital markets will only become more so as issuers attempt to meet their infrastructure and other financing needs during the balance of this century. It is estimated that 80% of the capital needs of state and local government during the rest of this decade will be raised through municipal bond issues. 42 Washington Financial Reports, April 2, 1984 at 550; *see also Localities Urged to Borrow More for Infrastructure*, The Bond Buyer, April 18, 1984 at 1.

Municipal bonds are largely held by individual investors who primarily are seeking safe, reliable investments providing a specified yield and, at maturity, a return of their investment. As stated in the Petition, the Washington Public Power Supply System (WPPSS) bonds are widely held by individuals. Chemical Bank and Washington Public Power Supply System, Petition for Certiorari, at 8-9 (February 4, 1985) [hereinafter cited as Petition]. This reliance upon the safety of municipal bonds as investments has not been without foundation. Since the depression of the 1930's, there have been relatively few defaults on the tens of thousands of issues of municipal bonds in which the American public has invested. Public Securities Association, FUNDAMENTALS OF MUNICIPAL BONDS, 1-3, 113 (1981). As a result of their historical stability, municipal bonds have been highly regarded as reliable investments giving issuers ready access to the capital markets. This investment reliability is based, in

important part, upon the settled nature of municipal finance law in all jurisdictions and the willingness of issuers of such obligations to abide by their contracts.

The municipal bond market has not, however, always enjoyed a reputation for stability and reliability. After the Civil War, state and local debt was issued to finance the building of railroads. The late nineteenth century brought the onset of depression and widespread disillusionment with unfulfilled promises by railroad developers. As a result, many defaults ensued and some issuers resorted to bond contract repudiation in an attempt to avoid payment. These repudiations were widely and fiercely challenged in the state courts and over two hundred of these challenges reached this Court. This Court almost invariably upheld the validity of the bonds and ordered municipal payment. In the end, the practice developed of obtaining independent legal opinions attesting to the legality of such municipal debt obligations. This development restored the market's reliability and efficiency.[1] *See* VI C. Fairman, HISTORY OF THE SUPREME COURT OF THE UNITED STATES, 918-1101 (1971); Public Securities Association, FUNDAMENTALS OF MUNICIPAL BONDS, 32-35, 47-48 (1981).

The practice of relying upon bond counsel opinions, and the market acceptance of those opinions, not only allayed concerns borne of the post-Civil War experience but also avoided the need to seek prior judicial approval of all potential questions concerning bond issuance. Necessarily, such opinions are based upon the application of judicial precedent and relevant legal principles. With great frequency it is necessary for counsel to apply established legal principles to a particular point of interpretation that has not been expressly determined by the courts. It is of no small importance that counsel be able to rely

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[1] Fairman writes of the period: "Eventually this wasteful experience ran its course. The regularity and confidence essential to sound municipal borrowing was attained by such developments as the rise of bond counsel . . . ." *Id.* at 1101.

upon the reasonable and natural application of such legal principles. It would be impossible to maintain the efficiency of the current municipal bond market if prior judicial determination was necessary in all, or even most, instances. Only a small number of new issues are presently examined by the courts prior to issuance. If the thousands of issues newly marketed each year required prior judicial decision, the courts would have time for little else and the market would be stultified.

The Decision Below. In this case, thousands of investors from across the nation have relied upon opinions of counsel proffered by the respondents as participants in the projects. Those counsel opined that the participants had the legal authority to enter into the contracts that very explicitly bound them to make certain payments whether or not the projects were completed, thus assuring the purchasers of the bonds that they would be repaid even if the projects failed. The participants also expressly represented that those obligations were duly authorized and validly given. Those opinions, and the participants' representations, were based upon existing statutory authority and prior judicial decisions. And as the Washington Supreme Court noted: "all parties assumed that statutory authority existed." *Chemical Bank* v. *Washington Public Power Supply System*, 102 Wash. 2d 874, 899, 691 P.2d 524, 538 (1984) [hereinafter cited as *Chemical Bank II*].[2]

Yet, in spite of that unanimous assumption, which was confirmed by legal opinions and formal governmental action, the Washington Supreme Court overruled the trial court determination of contract validity and held that many of the participants were without authority to enter into the financing commitments. It did so in a decision noteworthy, to put it mildly, for its breach of the rule of *stare decisis*. The majority opinion conveys the im-

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[2] *Chemical Bank* v. *Washington Public Power Supply System*, 99 Wash. 2d 722, 666 P.2d 329 (1983) will hereinafter be cited as *Chemical Bank I*.

pression of a single-minded effort to achieve a result that fully discharges the participants from all their obligations and deprives bond investors of their reasonable expectations. That opinion arbitrarily, categorically, and perfunctorily dismissed every conceivable ground that might support repayment of the bondholders. The majority dismissed claims of statutory authority under Washington statutes that (1) grant authority to purchase electricity [RCW 54.16.040; RCW 35.23.440 (44); RCW 35.24.290(3); RCW 35.27.370(4); RCW 35A.80.010; RCW 43.52.410], (2) give broad authority to WPPSS as a joint operating agency [RCW ch. 43.52], including a provision that such chapter be construed liberally [RCW 45.52.910], and (3) allow many of the participants to construct energy facilities [RCW 35.92.050]. After concluding that the participants had no authority to enter into the financing agreements that contained so-called "dry hole" obligations, the majority dismissed, with equal quickness and lack of substantive support, the equitable claims of estoppel and restitution. This denial of all remedy has been uniformly criticized by legal commentary as being an unsupportable and unpredictable result under pre-existing Washington law.[3]

The surprising and arbitrary nature of the majority opinion is most apparent from the strong dissent of three of the nine Justices of the Washington Supreme Court. In their dissent, those Justices make it clear that, in their view, the majority adopted special rules of statutory interpretation and imposed new requirements for statutory

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[3] *See* Witten & Hecht, *Whoops, There Goes Washington: Is California Next?*, 15 Pac. L.J. 955 (1984); Note, *Chemical Bank* v. *Washington Public Power Supply System: The Questionable Use of the Ultra Vires Doctrine to Invalidate Governmental Take-or-Pay Obligations*, 69 Cornell L. Rev. 1094 (1984); Comment, *Chemical Bank* v. *WPPSS: A Case of Judicial Meltdown*, 5 J. Energy L. & Pol'y 273 (1984); Comment, *Chemical Bank* v. *Washington Public Power Supply System: An Aberration in Washington's Application of the Ultra Vires Doctrine*, 5 U. Puget Sound L. Rev. 59 (1984); Note, *A Cry for Reform in Construing Washington Municipal Corporation Statutes*, 59 Wash. L. Rev. 653 (1984).

application; applying both retroactively to deprive the investors of their contract and property rights in order to avoid the imposition of increased utility charges on those who are voters in the State of Washington.[4] The unfortunate implication is that an elected state court, in grappling with an unpopular case, may have permitted political considerations to tip the scales of justice.

As a result, legal commentators, the investment community, and the public at large are understandably skeptical of the Washington Court's decision. The decision has been referred to as "strange" and "corrupting," [5] "dishonest" and protectionist,[6] and a politically popular decision [7] rendered by an "elected tribunal." [8] The Christian Science Monitor stated the premise bluntly: "Many investors regard the decision as political rather than legal. They believe the courts were searching for a way to bail out the utilities." [9]

This skepticism not only taints the credibility of the judiciary and undercuts our shared notions of political fairness but also impairs confidence in the municipal finance market to the detriment of all state and local governments. The dissent expresses understandable concern about the probable effects of the majority's decision upon the ability of Washington municipalities to finance their capital projects. *Chemical Bank II*, 102 Wash. 2d at 917, 691 P.2d at 548 (Utter, J., dissenting). And, public reaction to the WPPSS default suggests that the Washing-

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[4] *Chemical Bank II*, 102 Wash. 2d 874, 913, 691 P.2d 524, 546 (1984) (Utter, J., dissenting).

[5] *Up From Whoops*, Wall Street Journal, August 13, 1984, at 15.

[6] Comment, *Chemical Bank* v. *WPPSS: A Case of Judicial Meltdown*, 5 J. Energy L. and Pol'y 273, 298 (1984).

[7] Note, *A Cry For Reform In Construing Washington Municipal Corporation Statutes*, 59 Wash. L. Rev. 653, 660 (1984).

[8] *After Default the Questions of Blame and Duty Linger*, Washintgon Post, December 5, 1984 at 1, 16, col. 1.

[9] *Financial Fallout from Washington State's Bond Blast*, Christian Science Monitor, June 20, 1983 at 10, 11, col. 1.

ton decision has had a costly effect upon the bond market and bond prices.[10] True, such an effect may be ameliorated over time, as the market assesses whether *Chemical Bank II* can safely be characterized as an aberration. Still, so long as the decision below stands, the impression will nevertheless remain that at least one state court, in a case involving the largest default in municipal bond history, felt constrained to permit local financial exigencies to affect its application of legal precedent.

For these reasons, this Court should review the decision of the Supreme Court of Washington. Without such review, the underlying principles upon which municipal bond financing currently operates efficiently may be eroded, just as it was in the late nineteenth century. Fortunately, review was then granted and the foundations of public finance—the obligation of contract and legal predictability—were preserved. To allow the Washington Supreme Court decision to go unreviewed may prompt other state and local governments to resort to, or at least attempt to obtain, state court protection as an alternative to honoring the obligations of financial contracts that in hindsight prove to have been made for unsuccessful projects. Such a development could well undermine what is currently an efficient, effective, and very

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[10] *See A Belt and Suspenders,* Forbes, December 5, 1983, at 250, 250-251 (WPPSS "has done for bond sales what Baldwin-United has done for annuities."); *Whoops A $2 Billion Blunder*; *Fallout From a Record Default Spreads From Washington State to Wall Street,* Time, August 8, 1983, at 50 (investor confidence shaken); *All WPPSS Bonds Seen in Jeopardy Without BPA Aid,* The Bond Buyer, September 12, 1983, at 1 (WPPSS uncertainties have led to an interest rate increase of about 150 basis points for municipal bonds.); *Analysts Assess WPPSS Fallout,* Engineering News-Record, August 4, 1983, at 10 (WPPSS default "threw the whole system into question—the value of a legal opinion, the value of a rating. Utilities will . . . have to pay higher yields." quoting G. Friedlander, vice president at Smith Barney, Harris Upham & Co.); *Bank Makes Move To Force Record Bond Default,* Washington Post, July 23, 1983, at 1 (default could "cost municipalities hundreds of millions of extra dollars in financing charges").

desirable public finance marketplace to the detriment of not only all participants in that market but also the nation as a whole.

SUMMARY OF ARGUMENT

As demonstrated by the Petition, the Washington Supreme Court decision raises substantial federal questions under the Taking, Contract, and Due Process Clauses of the United States Constitution. We wish to emphasize the interests of bondholders and the unfortunate effect of that decision on the municipal bond market and to urge, from that perspective, that issues arising under both the Taking Clause and the Contract Clause require review by this Court. Specifically, the governmental inducement of the bondholders' investment and the subsequent denial of all remedies—including even simple restitution—are, from a municipal bond market perspective, the most pernicious aspects of the Washington Court's decision when reviewed under the Taking Clause. Similarly, from that perspective, a review of the Washington Court's decision under the Contract Clause is fully warranted under the particular circumstances here presented.

More generally, this case uniquely calls for the application of the constitutional principles underlying both the Taking Clause and the Contract Clause to eliminate the fundamental evil against which those clauses stand—the imposition of arbitrary or political actions or decisions that would reallocate wealth solely on the basis of regional or political favoritism.[11] Indeed, those principles must be applied in this case where state agency repudiation of contractual obligations is upheld by a state court decision, uniformly criticized for its protectionist focus and cavalier denial of remedial relief, that results in bil-

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[11] *See* Sunstein, *Naked Preferences And The Constitution*, 84 Colum. L. Rev. 1689 (1984). Many of the clauses of the Constitution focus on a single underlying evil: "the distribution of resources or opportunities to one group rather than another solely on the ground that those favored have exercised the raw political power to obtain what they want." *Id.* at 1689.

lions of dollars being transferred from the pockets of bondholders comprised primarily of out-of-state residents to the pockets of Washington state residents.

ARGUMENT

I. The Participants Have Unconstitutionally Taken The Bondholders' Property.

The cancellation of the participants' agreements, and the resultant transfer of billions of dollars from the bondholders to the participants and their ratepayers, amounts to a taking of private property in violation of the fifth amendment of the Constitution. The Washington Court in countenancing such contract repudiation not only upheld such action—but also eliminated all remedial relief—even the minimally compensatory right of restitution.

Petitioners have argued, and we agree, that the participants' abrogation of their contracts and retention of over two billion dollars in principal amount constitutes an unconstitutional taking under the decisions of this Court in *Penn Central Transportation Co.* v. *New York City*, 438 U.S. 104 (1978) and *Webb's Fabulous Pharmacies, Inc.* v. *Beckwith*, 449 U.S. 155 (1980). Two particularly outrageous aspects of the participants' actions draw special attention.

A. The Participants' Inducement and Subsequent Destruction of the Bondholders' Investment is an Unconstitutional Taking of Property.

This Court has held that government may not induce an investment, thereby creating a legitimate investment-backed expectation of private property, and then destroy that expectation by taking the property without just compensation. *Ruckelshaus* v. *Monsanto Co.*, 52 U.S.L.W. 4886, 4892, 81 L.Ed 2d 815, 838 (1984) ("explicit governmental guarantee formed the basis of a reasonable investment-backed expectation"); *Kaiser Aetna* v. *United States*, 444 U.S. 164 (1979).

There could be no clearer example than this case of intentional, governmental inducement leading to the

creation of an investment-backed expectation, followed by its destruction by the government. The participants contracted with and directed WPPSS; the participants hired counsel to give opinions; the participants entered into the bond financing transaction with clear awareness of the "dry hole" provision and its market significance; the participants allowed and authorized that transaction to go to the public bond market with the representation that the "dry hole" provision secured repayment of the bonds; indeed, the participants authorized WPPSS to go to that same public market *fourteen* times with that same representation. Thus participants intentionally and knowingly induced a $2.25 billion transfer of principal from private bondholders. After such transfer, and when their projects failed, the participants willfully destroyed the security for the bonds thereby eliminating all source of repayment.

The proposition that government may not encourage the private sector to incur investment costs and then proceed to take the completed investment without compensation is at least as applicable here as in *Kaiser*. Indeed, the governmental activity in *Kaiser* was mild compared to the participants' actions. The Army Corps of Engineers in *Kaiser* merely consented to the dredging of a pond and construction of a channel—activity that ultimately created a navigable body of water that the government claimed thereby became subject to public use. Yet, the Court in requiring compensation noted the government's inducement: "While the consent of individual officers cannot 'estop' the United States, it can lead to the fruition of a number of expectancies embodied in the concept of 'property'—expectancies that, if sufficiently important, the Government must condemn and pay for before it takes over the management of the landowner's property." *Kaiser*, 444 U.S. at 179 (citations omitted). It does not require intense analysis to view *Kaiser* as teaching that, while the unauthorized actions of individual officials may not contractually bind the municipality, they can lead to the fruition of expectations that at least must be paid for if taken. Certainly, the participants actively induced the

investment. It would be as if the Army Corps of Engineers in *Kaiser* had sought out the developer and given him a written guarantee that the completed marina would be his, instead of merely allowing the investment to be made.

Furthermore, like the developer in *Kaiser*, the bondholders did not accept the risk of confiscation of this governmentally induced investment. The bondholders took the risks normally assumed in the municipal bond market, namely that the value of their bonds might decrease and/or that the participants might default by reason of an *inability* to pay. Under no circumstance did the bondholders willingly take the risk that the participants might simply decide not to pay or more incredibly, that any decision to back out would be countenanced by the Washington Supreme Court in a decision that appears to create law solely to produce a preordained result. To assert that the bondholders took the risk of calculated breach of contract undercuts the very concept of contract, particularly in the municipal bond market. Fortunately, the Washington Court may not constitutionally use its *ex post facto* realignment of bondholder/participant risks to vindicate the participants' taking of the bondholders' investment. *Cf. Hughes* v. *Washington*, 389 U.S. 290, 296-97 (1967) (Stewart, J., concurring) ("a sudden change in state law, unpredictable in terms of relevant precedents . . . cannot be permitted to defeat" the Taking Clause). The fact is the bondholders made a loan to the participants—not a gift—and the "dry hole" provision not only induced the marketing of the bonds, but also determined precisely the allocation of risk. In sum, the bondholders held indebtedness, not equity, and assumed the market and default risks inherent in any municipal bond transaction. The participants obtained the benefit of the financing in support of their projects and assumed the risk that such projects might not be as successful as predicted or would even fail totally.

B. The Participants' Retention of the Principal Amount is an Unconstitutional Taking of Property.

The Washington Court, by denying any restitutionary remedy, has sanctioned the participants' unconstitutional taking of the bondholders' funds. To justify this result, the Washington Supreme Court concluded that the proceeds received from the sale of the bonds only benefited WPPSS as the joint operating agency and that, therefore, no restitution was due from the participants. *Chemical Bank II*, 102 Wash. 2d at 911, 691 P.2d at 545. This conclusion, however, ignores the fundamental facts. The participants caused WPPSS to act as their agent. Independent of the participants, WPPSS had no intention, no need, indeed no ability, to build the projects for which the bonds were issued. WPPSS was conceived, designed, and employed as nothing more than a conduit on behalf of, and for the convenience of, the participants. Thus, under any possible, fair analysis the benefit of the bond proceeds was intended for and ran to the participants. It was precisely to obtain such benefit, by assuring bond marketability, that the participants offered the "dry hole" inducements. *See United States Trust Co.* v. *New Jersey*, 431 U.S. 1, 18 (1977) (Bond marketability is a recognizable benefit.). WPPSS by itself could not, nor did it desire to, market a single bond for the projects without the involvement of, or except for the benefit of, the participants.

More to the point, is the question of by whom was the property destroyed. *See Ruckelshaus* v. *Monsanto Co.*, 52 U.S.L.W. 4886, 4891, 81 L.Ed 2d 815, 833-34, (1984); *United States* v. *General Motors Corp.*, 323 U.S. 373, 378 (1945) ("deprivation of the former owner rather than accretion of a right or interest to the sovereign constitutes the taking"). And, as to that determinative question there is no dispute but that the participants are solely responsible for the destruction of the bonds' value. It was the abrogation by the participants of their commitment to provide security for the bonds, and not failure of the projects, that destroyed the bonds' value. It is, ultimately, irrelevant whether WPPSS or the participants

received the benefit of the bonds. What is dispositive and beyond argument is the act of destruction and the actors involved: the participants' repudiation of contract and retention of principal as sanctioned by the Washington Supreme Court.

The Washington Court's decision also foreclosed any restitutionary remedy whatsoever on the basis of its conclusion that participants' assumption of "dry hole" obligations was substantially *ultra vires*. *Chemical Bank II*, 102 Wash. 2d at 910-911, 691 P.2d at 544-45. Even if one could accept the Washington Court's questionable interpretation of municipal authority, it cannot be plausibly asserted that such "authority . . . [was] so completely lacking it seems fair to presume bad faith on the part of the private party [bondholders]." *Noel* v. *Cole*, 98 Wash. 2d 375, 381 n.3, 655 P.2d 245, 250 n.3 (1982). Yet that bad faith presumption is necessary for a finding of substantive *ultra vires* and a denial of restitution under Washington law.[12] It is fundamentally indefensible for

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[12] The *Noel* court held that the lack of authority there alleged did not render the contract substantively *ultra vires* and hence restitution was awarded. The Court used a two part *ultra vires* test: (1) "the agency must have had the power it sought to exercise but merely have exercised it in an irregular manner or by unauthorized procedural means," and (2) "the action must not be *malum in se*, *malum prohibitum*, or manifestly against public policy." The Court held that the state "had the general authority to sell the timber rights" and the action was not so against public policy as to presume bad faith. *Noel*, 98 Wash. 2d at 381-82, 655 P.2d at 249-50.

Substantive *ultra vires* may defeat the demand for payment where no reasonable person could have thought the act authorized or if there is an express prohibition of the power purportedly exercised. *See* 10 E. McQuillin, MUNICIPAL CORPORATIONS, § 29.131 (3rd ed. 1981). It cannot be said either that there was a clear lack of authority to enter into the Participant Agreements or that the bondholders acted in bad faith. The Washington Court acknowledged that authority to enter into the "dry hole" obligations existed, if either control or ownership had been maintained by the participants. Moreover, it is beyond dispute that all concerned parties believed in good faith that the "dry hole" obligations were valid.

the Washington Court to have held that the participants' failure to exercise sufficient control over the projects—a requirement nowhere set forth in any relevant statute or imposed by prior judicial decision—amounts to substantively *ultra vires* activity. Indeed, it is disingenuous for the Washington Court to assert that there was a complete lack of authority for the participants' contracts when, prior to the decision in *Chemical Bank I*, the Washington legislature itself deemed it necessary to enact express restrictions on the authority of public bodies to conclude the "dry hole" contracts. *See infra* note 16. Moreover, both the trial court and three members of the Washington Court itself did not find the lack of authority in this instance to be clear. In that light, it is difficult to assert, much less conclude, that the bondholders either acted in bad faith or in disregard of the participants' complete "lack of authority." The Washington Court's finding of substantive *ultra vires*, however, rests entirely upon that flawed premise.

Except in the most extreme circumstances, municipal corporations have not been permitted to cite lack of authority to contract or incur indebtedness as a basis to enrich themselves by excusing their obligations to repay funds advanced. Many years ago, this Court held that: "While . . . the bonds cannot be enforced, because defectively executed, the money paid for them may be recovered back. . . . '[T]he obligation to do justice rests upon all persons, natural or artificial, and if a county obtains the money or property without authority, the law, independent of any statute, will compel restitution or compensation.'" *Louisiana* v. *Wood*, 102 U.S. 294, 299 (1880) (quoting *Marsh* v. *Fulton County*, 77 U.S. (10 Wall.) 676, 684 (1871)); *see also Logan County National Bank* v. *Townsend*, 139 U.S. 67 (1891); *Parkersburg* v. *Brown*, 106 U.S. 487 (1883); *Gillespie* v. *Yell County*, 124 F.2d 632, 637 (8th Cir., 1942) ("Persons who have innocently paid their money for [invalid] bonds are universally held to be entitled to recover . . . ."). Professor Palmer has similarly considered and addressed this issue. "It would

be a manifest injustice to permit a municipality to borrow money pursuant to an invalid promise to repay it, retain the money, or use it for a proper municipal purpose, and yet not be accountable for the enrichment." II G. Palmer, LAW OF RESTITUTION, § 12.18, at 670 n.11 (1978).

The underlying purpose and effect of these decisions is in accord with the Taking Clause. Just as a state may not arbitrarily redefine property rights, similarly it may not arbitrarily redefine, by "ipse dixit," contract rights or equitable remedies that amount to property interests. *Cf. Webb's Fabulous Pharmacies, Inc.* v. *Beckwith*, 449 U.S. 155 (1980); *Hughes* v. *Washington*, 389 U.S. 290, 296-97 (1967) (Stewart, J., concurring). Absent bad faith on the part of the lender, a municipality may not borrow money, albeit without authority to do so, and then refuse to repay the loan.[13] The Taking Clause prohibits such confiscation unless: (1) municipal authority is so completely lacking as to negate any inference of governmental action and to suggest bad faith on the part of the lender, or (2) the award of restitution would substantially undercut an express, legitimate state interest.[14] To read the Taking Clause in a more restrictive manner would gut it of any meaning in the municipal finance context. A municipality could always manage to borrow funds "illegally" and thereby avoid repayment pursuant to its contract, as well as the requirement of just compen-

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[13] *Cf. Murray* v. *Charleston*, 96 U.S. 432, 445 (1878) (a sovereign right to withhold or alter the terms of payment cannot be read into state contracts). *Murray* also must be read as disallowing a claim that special and obscure rules govern municipal authority to borrow and hence the obligation to repay. *Murray* minimally requires a restrictive *ultra vires* doctrine—only the most egregious (and therefore notorious) lack of authority, leading to the presumption of bad faith, can relieve the municipal obligation to return monies or benefits received in consideration for an invalid contract.

[14] Compare contracts made in direct violation of public bidding statutes. The award of quasi-contractual relief in such an instance would completely undermine the statute by allowing the municipality to reap the services and the contractor to be paid fair value. *See e.g., Gerzof* v. *Sweeney*, 22 NY2d 297, 239 N.E.2d 521 (1968).

sation. This would elevate municipalities to a level of sovereignty this Court found unacceptable a century ago. *See e.g., Murray* v. *Charleston*, 96 U.S. 432 (1878). And, if supported by decisions like *Chemical Bank II*, it would weaken to the detriment of all municipalities the reliability of contractual obligations on which the municipal bond market has rested since this Court's early repudiation of such conduct.

II. The Washington Supreme Court's Decision Unconstitutionally Impairs The Obligation Of Contract.

An apparent hurdle to an assessment of the Contract Clause issue present in this case is the Washington Court's conclusion that no authorized contract ever existed. However, a state court's interpretation as to the existence of a contract is necessarily reviewable as a question of federal constitutional law when the Contract Clause is implicated. *Appleby* v. *City of New York*, 271 U.S. 364 (1926); *cf. Webb's Fabulous Pharmacies, Inc.* v. *Beckwith*, 449 U.S. 155 (1980); *Hughes* v. *Washington*, 389 U.S. 290, 296-97 (1967) (Stewart, J., concurring). Thus, the Washington Supreme Court's attempt to deny the existence of the contract by "ipse dixit" or arbitrary change of state law, begins rather than precludes a "Contract Clause" inquiry.

The Washington Supreme Court's retroactive denial of municipal authority and release of the participants from their "dry hole" obligations is an unconstitutional impairment of the bondholders' contracts. The Contract Clause prevents the abrogation by a state of its own indebtedness. *United States Trust Co.* v. *New Jersey*, 431 U.S. 1, 17 (1977). Indeed, a state's abrogation of its own obligations is the most worrisome of contract impairments. State self-interest can, in such an instance, overwhelm traditional checks upon state action. This is especially true in the municipal bond context where the state has only a purely financial interest at stake. Indeed, only once in this century has alteration of a municipal bond contract been sustained by this Court and that was a case

where a bankrupt municipality was placed in receivership. *United States Trust*, 431 U.S. at 27 (citing *Faitoute Iron & Steel Co.* v. *City of Asbury Park*, 316 U.S. 502 (1942)). In this case, the participants, the bondholders, the trial court, the dissent in *Chemical Bank II*, legal commentary on that decision and, perhaps, even the Washington legislature all found, at one time or another, authority for the contracts under the applicable Washington statutes and prior Washington decisions governing statutory interpretation. The surprising opinion of the Washington Supreme Court, however, released the municipalities from their contractual obligation to provide the bond payments. Unless this Court grants certiorari and reverses the decision below, the municipal participants, having signed a contract pledging payment and having received its benefits for five years, will have successfully repudiated their contractual obligations when it appeared that they would become unexpectedly burdensome.

This Court's decision in *Tidal Oil Co.* v. *Flanagan*, 263 U.S. 444 (1924), does not preclude the Washington Court's decision from being subject to constitutional review under the Contract Clause. The policies behind *Tidal Oil* would not be disserved by reviewing the decision below under the Contract Clause. *Tidal Oil* was designed to avoid common law distortion by preventing every state court decision from becoming of constitutional dimension. Additionally, the exclusion of judicial decisions rested upon the belief that it is legislative misbehavior with which the Contract Clause was primarily concerned. *See* Epstein, *Toward A Revitalization of the Contract Clause*, 51 U. Chi. L. Rev. 703, 747-48 (1984). *Tidal Oil*, however, need not be read as precluding a review of state judicial abrogation of municipal financial obligations when it is apparent that such judicial action is merely serving as a substitute for, or an extension of, state legislative action.

Rather, in such situations state judicial review of contract authority, like state legislative impairment of such

contracts, should be subjected to more exacting review. *See United States Trust*, 431 U.S. at 26; *see also* Note, *A Process Oriented Approach to the Contract Clause*, 89 Yale L. J. 1623, 1627 (1980); Note, *The Constitutionality of the New York Municipal Wage Freeze and Debt Moratorium: Resurrection of the Contract Clause*, 125 U. Pa. L. Rev. 167, 187-90 (1976). The deference normally given to state court determinations cannot be justified when the impression is uniformly created among impartial observors that political considerations or regional preference may have influenced the reasoning proffered in support of those determinations.[15]

Moreover, this Court has undertaken review of state judicial decisions under the impairment clause when those decisions give effect to or enforce legislative action. *Tidal Oil*, 263 U.S. at 453 (citing with approval *Louisiana R. & Nav. Co.* v. *Behrman*, 235 U.S. 164, 170-71, (1914) and *Carondelet Canal Co.* v. *Louisiana*, 233 U.S. 362, 376 (1914)); *see also Columbia R. Co.* v. *South Carolina*, 261 U.S. 236, 245 (1923) ("[A]lthough the state court may have construed the contract and placed its decision distinctly upon its own construction, if it appears, upon examination, that in real substance and effect, force has been given to the statute complained of our jurisdiction attaches."); *Cross Lake Club* v. *Louisiana*, 224 U.S. 632, 638-39 (1912) ("[W]hen the state court, either expressly or by necessary implication, gives effect to a subsequent law of the state whereby the obligation of the contract is alleged to be impaired a federal question is presented."); *Terre Haute & I.R. Co.* v. *Indiana*, 194 U.S. 579 (1904). This result is supported by the legitimate concern that state self-interest in such circumstances has permeated the state judiciary. *See Mariniello* v. *Shell Oil Company*, 511 F.2d 853, 859 (3rd Cir., 1975) (In both *Columbia Railway* and *Terre Haute* this Court was confronted with

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[15] This Court's admonition in *Gelpcke* v. *City of Dubuque*, 68 U.S. (1 Wall.) 175, 206-07 (1864) is worth recalling: "We shall never immolate truth, justice, and the law, because a State tribunal has erected the altar and decreed the sacrifice."

state court decisions that "worked a substantial forfeiture of land or money in favor of the state government.").

In this case, the inference that the Washington Supreme Court, by its forced approach to statutory interpretation, may have been extending legislative action is clearly present and urges review by this Court. In this respect it should be noted that the Washington legislature banned unlimited "dry hole" commitments after the WPPSS default but before the decision in *Chemical Bank I*.[16] While the Washington Supreme Court did not expressly rely on the statutory amendment, it did acknowledge the enactment in a different context. More importantly, the result of its strained statutory interpretation was to give retroactive effect to the amendment as a practical matter. If, as unfortunately seems apparent, the Washington Court has chosen to join the fray by rendering a decision that seems little more than a practical replacement for legislative action, then by that choice it has made its decision subject to review as constituting an unlawful impairment of contract.

CONCLUSION

By its decision in *Chemical Bank II*, the Washington Supreme Court would push concepts of municipal finance back to the late nineteenth century, to the immediate relief of the participants but the continuing distress of the municipal bond marketplace. Fortunately, in that earlier era, this Court refused to permit municipal governments to repudiate their obligations just because the projects for

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[16] RCW 43.52.410 amended in 1983 to add the proviso: "[N]o city or district may enter into a contract or compact with an operating agency to purchase electric energy, or to purchase or participate in a portion of an electrical generating project, that commits the city or district to pay an amount in excess of an express dollar amount or in excess of an express rate per unit of electrical energy received." 1983 Wash. Laws, ch. 308 §1. This amendment passed the Washington Legislature April 22, 1983 and was approved by the Governor of Washington on May 17, 1983. *Chemical Bank I* was decided June 15, 1983.

which those obligations were assumed turned out to be unsuccessful or unpopular. Although the constitutional landscape has changed significantly in the past 100 years, the fundamental concepts protecting the property rights of citizens from abrogation by state and local government have not been abandoned. The application of those concepts to this case produce the conclusion that the Washington Court's reconstruction of state law constituted an impairment of the bondholders' contracts and that the participants' retention of the bondholders' funds constituted an uncompensated taking of private property. A review of this case by this Court is fully warranted, *inter alia*, to assure the application of those fundamental constitutional concepts for the protection of, and the maintenance of continued confidence in, the municipal bond market.

Amicus, therefore, respectfully suggests that the petition for a writ of certiorari to the Supreme Court of Washington should be granted.

Respectfully submitted,

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